

# ASIC overhaul requires paradigm shift

The elderly victims of the Sterling First scandal, robbed of their life savings by serial Ponzi schemers while the regulator, the Australian Securities and Investments Commission (ASIC), simply looked on and let it happen, are not an anomaly. The 10,000 submissions received by the 2018 Banking Royal Commission, and the 70,000 complaints received annually by the Australian Financial Complaints Authority (AFCA), demonstrate that the fundamental structure of Australia's financial system has enabled decades of financial predation and institutional highway robbery, and it must be changed, if not by the politicians from the top down, then by the people from the ground up.

In an [11 October 2021 YouTube interview](#) with Martin North of Digital Finance Analytics, Citizens Party Research Director Robert Barwick joined North in calling for Australians to contact their Senators and demand their support for an inquiry into Sterling First and ASIC. An inquiry is imperative to force the parliament to address the ongoing corruption and failings of Australia's financial system, which favours financial predators at the expense of hardworking Australians. As North observed, "It comes back to that same fundamental question, about the way finance works—who benefits and who is effectively the cannon fodder. ... At the moment ordinary people, businesses, households are the cannon fodder".

For decades, elderly Australians, such as the Sterling First victims, have been systematically targeted for exploitation by predatory banks and corporate crooks, while ASIC did nothing to prevent or punish misconduct. For example, a 2014 Senate inquiry into ASIC documented heartbreaking stories from many retirees defrauded out of their life savings and their homes by corrupt banks and financial professionals. Their stories are practically identical to those of the pensioners who would fall victim to the Sterling First scheme years later. The 2014 inquiry reported: "Many of the people who wrote to the committee were clearly hard-working Australians who over their lives had built up a nest egg so that they could support themselves comfortably in their retirement. ... People spoke of having to live on the breadline just to try to repay the money after having worked all their lives; paid their bills and taxes; and raised their family." The Committee was confounded by ASIC's failure to heed repeated warnings of corruption and misconduct, and by ASIC's apparent reluctance to act to prevent fraud and the theft of pensioners' life savings. Witnesses told the Committee that "ASIC ignores grassroots warnings of impending collapses and crisis", and complained of "ASIC's apparent indifference to indicators of misconduct by directors". Sadly reminiscent of today's Sterling First victims, the 2014 Committee reported that the retirees "felt humiliated and defeated by the whole business, which commonly had dragged on for years, draining their energy, damaging their personal relations as well as their physical and mental health".

The "rinse and repeat" nature of financial crime in Australia, which has allowed financial predators to steal from ordinary Australians, especially elderly people, without consequence for decades, demonstrates that the problem is baked into the system itself. As Martin North told Barwick on 11 October, "the way it's working today is by design. This isn't just an accident, it's deliberate."

## Failure by design

The fundamental policies for financial regulation in Australia were based on principles developed by the Campbell (1981) and Wallis (1997) inquiries. These principles were based on the "efficient markets theory", the belief that regulatory intervention should be kept to a minimum, to allow markets to drive efficiency. In a 2009 Senate inquiry initiated after the catastrophic collapse of Storm Financial and other high-profile collapses, ASIC confirmed that the "efficient markets theory" had shaped both Australia's financial regulation and ASIC's role and powers.

This ideology underpins ASIC's entire regulatory framework, and may explain much of ASIC's failure to protect the public. For example, during the 2009 inquiry, ASIC was slammed for its years of inaction on Storm, despite repeated warnings from financial professionals and complaints from desperate victims. However, ASIC excused its failure to warn the public, saying that "*[c]onsistent with the economic philosophy underlying the FSR [Financial Sector Reform] regime, ASIC does not take action on the basis of commercially flawed business models*". (Emphasis added.) However, ASIC's excuse doesn't stack up—rather than simply a "flawed business model", a court would later find Storm's directors were negligent and guilty of providing inappropriate financial advice, which wiped out hundreds of Australians, many of them elderly people.



Commissioner Kenneth Hayne was damning at the banking royal commission of ASIC's practice of negotiating with the banks, which he said undermined its enforcement of the law. Photo: Screenshot

In his 2019 final report, Banking Royal Commissioner Hayne slammed ASIC's "deeply entrenched culture of negotiating outcomes rather than insisting upon public denunciation of, and punishment for, wrongdoing". A preference for negotiating compliance made ASIC susceptible to regulatory capture by those it regulated, and led to the perception that compliance with the law was voluntary. Hayne stated that "improving compliance with financial services laws cannot be achieved by focusing only on negotiation and persuasion". (Emphasis added.)

However, from its inception ASIC was designed to prefer negotiation as a method to coax compliance from those it regulates. The 1997 Wallis Inquiry recommended the founding of ASIC, and determined how the agency would operate. As reported 1 October 2018 by *Banking Day*, the Wallis Inquiry, which was headed by former AMP Chair Stan Wallis, recommended a "light-touch" regulatory regime and "argued for a fresh way of regulating that included new forms of self-regulation and a hybrid model, known as 'co-regulation'. The hybrid model involved statutory agencies such as ASIC *working cooperatively with banks* and other industry providers to facilitate self-regulation through voluntary codes of conduct." (Emphasis added.) In its final report, the Wallis panel recommended that "[w]here industry standards and performance suggest that the most practicable method involves self-regulation or co-regulation, *such methods should be preferred*". (Emphasis added.)

Although Commissioner Hayne sternly emphasised that "[f]inancial services entities are not ASIC's 'clients'", and that "ASIC does not perform its functions as a service to those entities", this cosy relationship of "co-regulation" is how the Wallis Inquiry preferred ASIC to function.

One of the Wallis Inquiry's key recommendations was that responsibility for policing consumer protection for financial products be transferred from the Australian Competition and Consumer Commission (ACCC), to instead be overseen by ASIC. Grave concerns were raised at the time by the 1997 Hanratty report, which correctly foresaw the risk of conflicts of interest and potential detriment to consumers.

In the 2009 post-Storm inquiry, ASIC admitted the Wallis approach to regulation may have no longer been appropriate: "[ASIC is] querying whether it has gone far enough in protecting retail investors, given the important role, which was not foreseen by the Wallis inquiry, that retail investors [including retirees] would play in the market."

Even key architects of the Wallis regime admit its underlying ideology was a mistake, albeit decades too late for ordinary Australians ruined because of ineffective financial regulation. As reported by the 24 April 2018 *Sydney Morning Herald*, one of the Wallis Inquiry panellists, Professor Ian Harper, now a Reserve Bank of Australia board member, admitted: "We placed too much faith in the efficient-market hypothesis and in light-touch regulation.... With the benefit of hindsight and what's been coming out at the royal commission, the weaknesses of the specialist approach we took to regulation are also evident." In a parliamentary inquiry hearing on 18 November 2020, Harper said he had now "changed [his] mind" and believed that consumer protection should be returned to the ACCC.

As Martin North pointed out on 11 October, the design of Australia's financial system was deliberate, and it was determined by the banker-run Wallis Inquiry. It is no surprise, therefore, that while this system has resulted in tens of thousands of ordinary Australians becoming financial "cannon fodder", it has simultaneously facilitated the rise of Australia's Big Four, which are among the world's most profitable banks. As the Productivity Commission's 29 June 2018 report on competition in Australia's financial system observed, "Australia's banking sector is an established oligopoly.... The four major banks as a group hold substantial market power.... This is substantially supported by regulatory settings, which contribute to the major banks' structural advantages."

If, as Commissioner Hayne emphasised, compliance with financial law cannot be achieved by focusing only on negotiation, Australians should ask if the outcomes of ASIC's negotiate-first model were also deliberate—since the regulator's systemic failure to regulate has wildly enriched Australia's allpowerful big banks.

The "light-touch" regulatory architecture developed by the Wallis Inquiry is the foundation of

Australia's financial system, and the consequences are evident. For example, in 2012 ASIC Chair Greg Medcraft told a parliamentary committee: "I guess the warning we have to Australians is frankly what we have is a system that is based on self-execution and relies on people to do the right thing. ... [I]t is up to the gatekeepers to do the right thing". Two years later, Medcraft would admit that Australia was a "paradise ... for white-collar [criminals]".

## **Bank-loyalist politicians fight to protect the current system**

As the Citizens Party has documented, bank-loyalist politicians are fighting tooth and nail to protect the status quo and keep ASIC ineffective and weak. A contrived financial scandal provided the excuse for Treasurer Josh Frydenberg's ouster of former ASIC Chair James Shipton and Deputy Chair Daniel Crennan, who had dramatically stepped up courtbased enforcement in response to the recommendations of the Royal Commission. Frydenberg has installed his preferred "business-friendly regulator", Joe Longo, in Shipton's place. Longo had previously overseen years of regulatory failings as the former head of ASIC's enforcement in 1996-2000, before leaving to join scandal-wracked Deutsche Bank's legal team. After seventeen years at Deutsche, Longo is now in charge of ASIC, and has already overturned the Royal Commission's recommendation of "why not litigate?", in favour of the wet-lettuce Enforceable Undertakings (EU) which were slammed by Hayne. In Longo's revived focus on EUs, he is driving ASIC back to its regulation-by-negotiation roots, which Commissioner Hayne stated would not achieve compliance with financial laws. In the aforementioned 2014 Senate inquiry which followed scandals caused by predatory financial professionals and corrupt banks, a former ASIC media adviser told the Committee that EUs were discussed and fought over, "over months, by armies of lawyers in secret behind closed doors and few details ever emerged about how the damage to investors was done, how many investors were affected, or even whether the undertaking was adhered to. ... Everything seemed to go silent after a brief but meticulously crafted press announcement was released by ASIC." As Andrew Schmulow, senior law lecturer at the University of Wollongong, wrote in the 27 August 2021 *Conversation*, [Frydenberg's new Statement of Expectations](#) for ASIC released in August has "throw[n] the banking royal commission under a bus", as it demands the regulator focus on contributing to "the government's economic goals" instead of enforcing the law.

## **The solution: effective regulation 'by design'**

As Martin North observed on 11 October, the way that Australia's financial system works today is by design. Importantly, because Australia's current regulatory system is a deliberate model, North explained: "that also means that you can have an alternative deliberate model", which could intentionally be designed "to benefit households and businesses and ordinary Australians, not just the big end of town". This attitude could translate into a "completely different set of policies", which "would generate more jobs, generate more equity for real Australians, take away some of the financial pressures that are in the system and put the banks back in their box". Rather than "money on money on money" being the "end game" of the financial system, finance could be used to facilitate real investment into the productive economy.

North's view was echoed by a 2016-18 Senate inquiry into the regulation of protection of consumers in the financial industry. The Committee observed that "[t]he large number of recent inquiries into the banking, insurance and financial services sector demonstrates the systemic problems inherent in the current system ... there is a need for serious reform to the entire financial services system".

A Senate inquiry into Sterling First is imperative, as the scandal is living proof of ASIC's ongoing regulatory negligence and the fact that, two and a half years after the Banking Royal Commission, nothing has materially changed. Australians must demand that Senators examine the structural issues which led to the Sterling First disaster, because the systemic failings of Australia's regulators leave all of the public vulnerable to being financial "cannon fodder" for the corrupt financial system.

*By Melissa Harrison, Australian Alert Service, 13 October 2021*